

VZCZCXRO1151
RR RUEHBZ RUEHJO RUEHMR RUEHRN
DE RUEHSB #0118/01 0440904

ZNR UUUUU ZZH

R 130904Z FEB 09

FM AMEMBASSY HARARE

TO RUEHC/SECSTATE WASHDC 4040

INFO RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE

RUEHUJA/AMEMBASSY ABUJA 2198

RUEHAR/AMEMBASSY ACCRA 2629

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RUEHRL/AMEMBASSY BERLIN 1228

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UNCLAS SECTION 01 OF 04 HARARE 000118

AF/S FOR B. WALCH

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ADDIS ABABA FOR USAU

ADDIS ABABA FOR ACSS

AGRICULTURE FOR RONALD LORD

COMMERCE FOR ROBERT TELCHIN

TREASURY FOR D. PETERS AND T. RAND

STATE PASS TO USAID FR L.DOBINS AND E.LOKEN

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SUBJECT: ZIMBABWE'S BANKING SECTOR NOT YET OUT OF THE WOODS

REF: HARARE 00096

SUMMARY

¶1. (SBU) Dollarization introduced in the January 2009 Monetary Policy Statement (MPS) brought relief to the banking sector. Banking had become unsustainable as Zimbabwe dollar denominated revenue failed to cover rising foreign currency denominated costs. The continued depreciation of the local currency and hyperinflation compounded the sector's predicament. Dollarization allows institutions to levy charges and lend in foreign exchange, thus improving the banks' viability. But problems related to the introduction of statutory reserves and ceilings on lending rates still militate against profitability at most banks. These constraints need to be addressed in order to allow the sector to play an effective role in Zimbabwe's economic recovery. END SUMMARY.

Banks Welcome Partial Dollarization

¶2. (SBU) Commercial and merchant banks welcomed the partial dollarization of their income in the January MPS (reftel). John Mushayavanhu, Managing Director of First Bank Limited and Deputy President of the Bankers' Association of Zimbabwe (BAZ), told economic specialist on February 10 that most of the costs of financial institutions have been denominated in U.S. dollars while their income up until now has been entirely in local currency. In fact, Fulton Chibaya, Chief Executive Officer of Genesis Financial

Holdings Limited, told economic specialist on February 11 that banks had stopped lending in the last quarter of 2008 because no one wanted Zimbabwe dollars anymore. With workers demanding salaries in U.S. dollars, banks were finding it increasingly difficult to remain viable.

Business Not Likely To Boom Immediately

¶3. (SBU) Mushayavanhu explained that the partial dollarization of the sector enabled banks to levy charges in foreign exchange on foreign currency account (FCA) transactions. The income would help the banks cover their foreign exchange denominated costs. In the short term, he predicted that revenue would be predominantly from transaction fees. Mushayavanhu did not envisage an increase in lending due to the foreign currency shortage. Furthermore, he said the thin margins arising from high costs combined with the interest rate limit of LIBOR plus 1-6 percent prescribed by the Reserve Bank of Zimbabwe (RBZ) made lending unattractive. Mushayavanhu calculated that with 1-month LIBOR at the very low rate of 0.45 percent as of February 10, the interest rate on loans was capped at only 6.45 percent. Qonly 6.45 percent.

New Business Model Required

¶4. (SBU) Both Chibaya and Mushayavanhu told us that the banks' network of branches throughout the country was designed for trade in

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Zimbabwe dollars. Chibaya said that the recent shift to hard currencies did not fit the model; there was insufficient foreign currency in circulation to support the huge overhead. He predicted most banks would suffer losses for a while before returning to profitability. Mushayavanhu told us that banks were re-establishing relationships by luring clients to open FCAs. Merchant banks, on the other hand, have maintained lean structures historically and are therefore better able to be profitable in the short term, in Chibaya's view. Nevertheless, they are also busy encouraging major exporters to open FCAs in their books.

¶5. (SBU) Chibaya told us that the MPS was positive in that it encouraged banks to lend to the productive sectors. However, he did not envisage any growth in lending in Zimbabwe dollars. Most companies needed to recapitalize their businesses and needed foreign currency to do so. Nor did he foresee short-term growth in the sector due to the lack of foreign exchange, but he hoped that foreign financial inflows would resume immediately following the formation of an inclusive government.

Salaries and Other Costs Now In Foreign Currency

¶6. (SBU) With regard to costs, Mushayavanhu told us that salaries and wages for bank employees will now be paid in foreign currency, with the minimum monthly wage at around US\$120. However, he pointed out that in last year's collective bargaining agreement, the minimum wage was set at US\$311 and converted into Zimbabwe dollars at the ruling inter-bank exchange rate. He said such rates, now payable in foreign currency, were unsustainable today. Banks could not generate the revenue in foreign exchange to pay high salaries, but Mushayavanhu foresaw a narrowing of salary differentials between the lowest and highest paid employees.

Statutory Reserve Requirements Increase Costs

¶7. (SBU) In the MPS, the RBZ introduced a 10 percent statutory reserve requirement on FCA deposits and lowered the requirement on Zimbabwe dollar denominated deposits from 50 percent to 15 percent. Mushayavanhu lamented the introduction of statutory reserves on

FCAs. He questioned whether the money would be available on demand at the RBZ in view of the RBZ's history of expropriating the FCAs of companies and NGOs. (NOTE: Statutory reserves must be held at the RBZ; vault cash does not count toward required reserves. END NOTE.)

Both bankers agreed that the statutory reserves would raise costs Q Both bankers agreed that the statutory reserves would raise costs which the banks would not be able to recover from lending or other activities. Chibaya told us that the imposition of statutory reserves and interest rates on FCA deposits, while designed to attract clients, would erode margins further. He believed the introduction of statutory reserves on FCA deposits reflected the RBZ's desperate need for foreign currency. Hardly a week after announcing the measure, the RBZ was calling on banks to pay up. Mushayavanhu told us that the announcement to localize the FCAs of platinum and diamond mining companies was driven by the RBZ's need to access as much foreign exchange as possible through the statutory reserves that arise from such new deposits. However, Mushayavanhu noted that banks whose clients' FCAs had been raided by the RBZ and not repaid were setting off such amounts for statutory reserves with the concurrence of the RBZ.

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¶ 18. (SBU) The banks are also concerned about the method used to calculate statutory reserves. Because banks have to pay the reserves every Monday for the previous week's deposits, Mushayavanhu feared that they may have to pay reserves on deposits that are no longer on their books. For example, the RBZ allows clients to withdraw as much as US\$250,000 from their FCAs at any time, "no questions asked." Chibaya told us that the amount was variable, and could be as high as US\$1 million. If a large withdrawal occurred on a Saturday, statutory reserves would still have to be paid on the following Monday.

¶ 19. (SBU) A senior executive at CBZ Bank Limited (where Gideon Gono served as CEO before becoming Governor of the RBZ) told economic specialist on February 12 that Gono had set the foreign exchange withdrawal ceiling too high - probably to allow ZANU-PF cronies to move large amounts of money out of the country easily - but to the detriment of the banking sector.

RBZ No Longer Lender of Last Resort

¶ 10. (SBU) Another challenge highlighted by Mushayavanhu related to clearances. The RBZ can no longer act as a lender of last resort for hard currencies (as it has for the Zimbabwe dollar) since the RBZ itself is short of foreign exchange. In addition, commercial and merchant banks do not have foreign currency denominated bank accounts in Zimbabwe to smooth out the clearing system. Mushayavanhu explained that settlement has to be done offshore, which will lengthen the clearing process.

No Problem with Capital Adequacy

¶ 11. (SBU) The RBZ in the MPS restated that commercial and merchant banks have a minimum capital requirement of US\$12.5 million and US\$10 million respectively. Chibaya and Mushayavanhu concurred that this did not pose a problem for the banks because certain fixed assets, such as buildings, are considered part of shareholder funds. Since most banking institutions own buildings they will find it relatively easy to meet the minimum capital requirement.

COMMENT

¶ 12. (U) Commercial and merchant banks are hopeful that dollarization will drive the sector's recovery. However, Zimbabwe's capacity to go it alone has been crippled by years of poor macroeconomic policies that have reduced exports to a trickle. Kick starting recovery will require a large injection of foreign currency. Even

with the inclusive government in place, and assuming the beginning of political and economic reform, it will take some time before donors and the international financial institutions develop the confidence to reengage with the GOZ. In the short-term, the banking sector may still face innumerable problems that will require it to restructure and downsize operations to survive. Further reforms are needed in the sector; banks should be allowed to offer competitive interest rates to mobilize savings that can be channeled to

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productive areas; and the ceiling on lending rates must be removed if banks are to play their intermediary role effectively. END
COMMENT.

DHANANI